

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Hillsdale County Road Commission	County Hillsdale
Audit Date December 31, 2004	Opinion Date May 5, 2005	Date Accountant Report Submitted to State: June 24, 2005	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

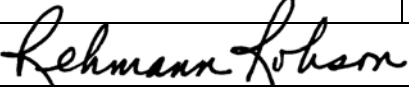
1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- | | |
|---|---|
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	X		
Reports on individual federal financial assistance programs (program audits).			X
Single Audit Reports (ASLGU).			X

Certified Public Accountant (Firm Name) REHMANN ROBSON GERALD J. DESLOOVER, CPA			
Street Address 5800 GRATIOT, PO BOX 2025	City SAGINAW	State MI	Zip 48605
Accountant Signature 			

Hillsdale County Road Commission

(a Component Unit of Hillsdale County)

Hillsdale, Michigan

FINANCIAL STATEMENTS

For The Year Ended December 31, 2004



REHMANN ROBSON

Certified Public Accountants

HILLSDALE COUNTY ROAD COMMISSION
(a Component Unit of Hillsdale County)

TABLE OF CONTENTS

	<u>PAGE</u>
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-8
Basic Financial Statements for the Year Ended December 31, 2004	
Statement of Net Assets and General Fund Balance Sheet	9
Reconciliation of General Fund Balance Sheet to Statement of Net Assets	10
Statement of Activities and General Fund Revenues, Expenditures and Changes in Fund Balance	11
Reconciliation of the General Fund Revenues, Expenditures and Changes in Fund Balance to the Statement of Activities	12
Statement of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual – General Fund	13
Notes to Financial Statements	14-23
Operating Fund Schedules	
General Operating Fund – Schedule of Changes in Fund Balance	24
General Operating Fund – Schedule of Revenues	25
General Operating Fund – Schedule of Expenditures	26
Internal Control and Compliance	
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	27-28



REHMANN ROBSON

Certified Public Accountants

A member of **THE REHMANN GROUP**



INDEPENDENT AUDITORS' REPORT

May 5, 2005

Members of the Board of County
Road Commissioners
County of Hillsdale, Michigan
Hillsdale, Michigan

We have audited the accompanying financial statements of the governmental activities and the major fund of the **HILLSDALE COUNTY ROAD COMMISSION**, a component unit of Hillsdale County, Michigan, as of and for the year ended December 31, 2004, which collectively comprise the Road Commission's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Hillsdale County Road Commission's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the major fund of the **Hillsdale County Road Commission** as of December 31, 2004, and the respective changes in financial position thereof and the budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 5, 2005, on our consideration of the **Hillsdale County Road Commission's** internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3-8 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements which collectively comprise the Road Commission's basic financial statements. The schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements of the **Hillsdale County Road Commission**. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink, reading "Lehmann Johnson". The signature is written in a cursive, flowing style with a large initial 'L'.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis

As management of the Hillsdale County Road Commission, we offer readers of the Road Commission's financial statements this narrative overview and analysis of the financial activities of this component unit of Hillsdale County, Michigan, for the fiscal year ended December 31, 2004. We encourage readers to consider the information presented herein, in conjunction with additional information that is furnished in the financial statements and notes to the financial statements.

Financial Highlights

- The Road Commission received \$8,106,494 in revenues for our 2004 operations. Our expenditures for the year totaled \$8,009,331. This resulted in an operating surplus of \$97,163 for the year. The ending available operating fund balance increased to \$1,341,568. It is important to note that the fund balance included inventories of parts and road materials which are not available to us as cash. Our year-end cash and investment balance was a very meager \$179,553, which was only 2.2% of revenues. This was our lowest cash balance in over 15 years, and will require us to watch our 2005 expenditures very closely.
- This is the second year that the Road Commission has had to comply with GASB 34 standards. Our infrastructure assets for roads, bridges and land improvements increased \$1,158,739 over 2003 for an asset total of \$26,030,680.

Overview of the Financial Statements

This discussion and analysis is intended to provide a basis for understanding the Commission's financial statements. The Commission's basic financial statements comprise three components:

- 1) Government-wide financial statements
- 2) Fund financial statements
- 3) Notes to the financial statements.

To simplify financial reporting and improve readability, the government-wide financial statements and the fund statements have been combined to report the statement of net assets and general fund balance sheet on a single page and the statement of activities and general fund revenues, expenditures and changes in fund balance on a single page. This report also contains other supplementary information in addition to the basic financial statement themselves.

Government-wide Financial Statements

The statement of net assets presents information on all of the Commission's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as an indicator of the Commission's overall financial position.

The statement of activities presents information showing how the Commission's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in past or future fiscal periods (for instance, depreciation expense associated with capital assets).

The Commission is principally supported by federal and state shared revenues (operating grants) with contributions from the townships. The governmental activities of the Commission include providing construction, repair, maintenance and snow removal of county roads within Hillsdale County. The Commission also maintains state highways within Hillsdale County under contract with MDOT.

The government-wide financial statements include only the Commission itself (known as the primary government). The Commission has no legally separate component units for which the Commission is financially accountable. In this report, financial information for this Commission is reported separately from the financial information presented for Hillsdale County which reports the Commission as a component unit.

Fund financial statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Commission, like other units of state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The activity of the Commission is accounted for in a governmental fund (General Fund).

Governmental funds. *Governmental funds* (General Fund) are used to account for essentially the same function reported in the government-wide financial statements. However, unlike the government-wide financial statements, general fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of the general fund is narrower than that of the government-wide financial statements, it is useful to compare the information presented for the general fund with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the general fund balance sheet and the general fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between general fund and government-wide statements.

The Commission maintains one governmental fund (the General Fund). Information is presented in the general fund balance sheet and in the general fund statement of revenues, expenditures, and changes in fund balances for the Commission. The general fund is a major fund for financial reporting purposes as defined by GASB Statement #34.

The Commission adopts an annual appropriated budget for its fund and revises the same as the year progresses when needed. Budgetary comparison statements have been provided herein to demonstrate compliance with those budgets.

The basic governmental fund financial statements can be found on pages 9 and 11 of this report.

The Commission does not maintain proprietary nor fiduciary funds.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the Commission's financial statements. The notes to the financial statements can be found on pages 14 through 23 of this report.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information*. This is limited to this management discussion and analysis.

Condensed Statement of Net Assets

	<u>2004</u>	<u>2003</u>
Current and Other Assets	\$ 1,764,273	\$ 1,837,174
Capital Assets	<u>29,332,264</u>	<u>28,271,838</u>
Total Assets	<u>\$ 31,096,537</u>	<u>\$ 30,109,012</u>
Long-term liabilities outstanding	(482,445)	(333,906)
Other liabilities	<u>(422,705)</u>	<u>(592,769)</u>
Total liabilities	<u>\$ (905,150)</u>	<u>\$ (926,675)</u>
Net assets:		
Invested in capital assets, net of related debt	29,198,629	28,271,838
Restricted	0	0
Unrestricted	<u>992,758</u>	<u>910,499</u>
Total net assets	<u>\$ 30,191,387</u>	<u>\$29,182,337</u>

Condensed Statement of Activities

	<u>2004</u>	<u>2003</u>
Revenue		
Charges for services	\$ 1,873,766	\$ 1,425,956
Operating grants & contributions	5,344,640	5,242,960
Capital grants & contributions	<u>724,046</u>	<u>547,903</u>
General Revenue:		
Interest income	10,542	17,714
Sale of building/land	0	85,000
Total Revenue	<u>\$ 7,952,994</u>	<u>\$ 7,319,533</u>
Expenses		
Public Works	\$ (6,943,944)	\$(6,560,261)
Debt Service-Principal		
Total Expenses	<u>\$ (6,943,944)</u>	<u>\$(6,560,261)</u>
Increase in NGI assets before special items	\$ 875,415	\$ 674,272
Special items-sale of building/land		85,000
Special items-debt service-principal	<u>133,635</u>	<u>0</u>
Increase in net assets	\$ 1,009,050	\$ 759,272
Net assets –beginning of year	<u>29,182,337</u>	<u>28,423,065</u>
Net assets – end of year	<u>\$ 30,191,387</u>	<u>\$ 29,182,337</u>

Capital Assets and Debt Administration

Hillsdale County Road Commission Capital Assets

	<u>2004</u>	<u>2003</u>
Land	\$ 74,434	\$ 74,434
Land improvements – Infrastructure	<u>3,703,315</u>	<u>3,280,407</u>
Sub-Total	<u>3,777,749</u>	<u>3,354,841</u>
Buildings	1,633,827	1,696,128
Road Equipment	1,307,812	1,297,077
Shop Equipment	42,213	46,474
Office Equipment	27,161	46,938
Engineering Equipment	15,225	21,393
Yard & Storage Equipment	197,668	214,209
Depletable Assets	3,244	3,244
Infrastructure (Roads & Bridges)	<u>22,327,365</u>	<u>21,591,534</u>
Sub-Total	<u>\$ 25,554,515</u>	<u>\$ 24,916,997</u>
Total Capital Assets	<u>\$ 29,332,264</u>	<u>\$ 28,271,838</u>

Additional information on the Commission's capital assets can be found in note 3 on page 20 of this report.

Long-term Debt	<u>2004</u>	<u>2003</u>
Bonds Payable	\$ 0	\$ 0
Lease Purchase Agreements	133,635	0
Compensated absences	<u>348,810</u>	<u>333,906</u>
Total	<u>\$ 482,445</u>	<u>\$ 333,906</u>

Additional information on the Commission's long-term debt can be found in note 1 on page 18 of this report.

Economic Factors and Road Fund Budgetary Highlights

The Road Commission amended its 2004 budget during the year to reflect an approximate \$300,000 increase in Michigan Transportation Funds (MTF) due to the one time increase in revenues due to the change in licensing trailers (permanent plates) and the revenues received (\$153,500) from the lease purchase agreement for a new Komatsu excavator that the Board decided to finance over 2 years. Other minor adjustments were made so the budget more closely matched anticipated revenues and expenditures. Revenues exceeded expenditures by \$97,163 in 2004.

For 2005, revenues are expected to be roughly \$1.5 million less than 2004 due to an expected 2.8% decrease in MTF funds, no federal buy-out funds for a large primary road project, and no critical bridge replacements. The only federal project in 2005 will be a safety project to replace the Moore Road bridge and reconstruct the curve. 2005 will primarily be a maintenance year for the road commission.

Requests for Information

This financial report is designed to provide a general overview of the Commission's finances for all those with an interest in the component unit's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Clerk, Hillsdale County Road Commission, 1919 Hudson Road, Hillsdale, MI 49242.

BASIC FINANCIAL STATEMENTS

HILLSDALE COUNTY ROAD COMMISSION

STATEMENT OF NET ASSETS AND GENERAL FUND BALANCE SHEET

DECEMBER 31, 2004

	General Fund	Adjustments	Statement of Net Assets
ASSETS			
Cash and cash equivalents	\$ 179,553	\$ -	\$ 179,553
Accounts receivable			
Michigan transportation funds	797,935	-	797,935
Due on county road agreements	60,365	-	60,365
Other	46,358	-	46,358
Accrued interest receivable	673	-	673
Inventories			
Road materials	551,043	-	551,043
Equipment material and parts	115,318	-	115,318
Prepaid insurance	3,705	-	3,705
Deferred expense - Federal and State aid	9,323	-	9,323
Capital assets			
Assets not being depreciated	-	3,777,749	3,777,749
Assets being depreciated	-	25,554,515	25,554,515
Total assets	\$ 1,764,273	\$ 29,332,264	\$ 31,096,537
LIABILITIES			
Accounts payable	\$ 88,880	\$ -	\$ 88,880
Notes payable (short term)	29,189	-	29,189
Accrued liabilities	95,136	-	95,136
Escrow deposits	9,150	-	9,150
Advances	200,350	-	200,350
Long-term liabilities			
Due within one year	-	75,218	75,218
Due after one year	-	407,227	407,227
Total liabilities	422,705	482,445	905,150
FUND BALANCES/NET ASSETS			
Fund balances:			
Reserved for inventories	666,361	(666,361)	-
Unreserved			-
Undesignated	675,207	(675,207)	-
Total fund balances	1,341,568	(1,341,568)	-
Total liabilities and fund balance	\$ 1,764,273		
Net Assets:			
Investment in capital assets, net of related debt		29,198,629	29,198,629
Unrestricted		992,758	992,758
Total net assets		\$ 30,191,387	\$ 30,191,387

The accompanying notes are an integral part of these financial statements.

HILLSDALE COUNTY ROAD COMMISSION

Reconciliation of General Fund Balance Sheet to Statement of Net Assets

DECEMBER 31, 2004

Fund balances - General Fund	\$ 1,341,568
Amounts reported for <i>governmental activities</i> in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.	29,332,264
Certain liabilities, such as compensated absences and loans payable, are not due and payable in the current period and therefore are not reported in the funds.	<u>(482,445)</u>
Net assets of governmental activities	<u>\$ 30,191,387</u>

The accompanying notes are an integral part of these financial statements.

HILLSDALE COUNTY ROAD COMMISSION

STATEMENT OF ACTIVITIES AND GENERAL FUND REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE

FOR THE YEAR ENDED DECEMBER 31, 2004

	<u>General Fund</u>	<u>Adjustments</u>	<u>Statement of Activities</u>
EXPENDITURES/EXPENSES			
Current:			
Public works	\$ 7,989,466	\$ (1,045,522)	\$ 6,943,944
Debt service			
Principal	19,865	(19,865)	-
TOTAL EXPENDITURES/EXPENSES	<u>8,009,331</u>	<u>(1,065,387)</u>	<u>6,943,944</u>
PROGRAM REVENUES			
Charges for services	1,873,766	-	1,873,766
Operating grants and contributions:			
State	5,344,640	-	5,344,640
Federal	724,046	-	724,046
TOTAL PROGRAM REVENUES	<u>7,942,452</u>	<u>-</u>	<u>7,942,452</u>
NET PROGRAM EXPENSES/REVENUE			<u>998,508</u>
GENERAL REVENUES			
Interest earned	10,542	-	10,542
Proceeds from installment lease	153,500	(153,500)	-
TOTAL GENERAL REVENUES	<u>164,042</u>	<u>(153,500)</u>	<u>10,542</u>
NET CHANGE IN FUND BALANCE	97,163	(97,163)	
CHANGES IN NET ASSETS		1,009,050	1,009,050
FUND BALANCE/NET ASSETS,			
Beginning of year	<u>1,244,405</u>	<u>27,937,932</u>	<u>29,182,337</u>
FUND BALANCE/NET ASSETS, End of year	<u><u>\$ 1,341,568</u></u>	<u><u>\$ 28,849,819</u></u>	<u><u>\$ 30,191,387</u></u>

The accompanying notes are an integral part of these financial statements.

HILLSDALE COUNTY ROAD COMMISSION

Reconciliation of the General Fund Revenues, Expenditures and Changes in Fund Balance to the Statement of Activities

YEAR ENDED DECEMBER 31, 2004

Net change in fund balances - General Fund	\$ 97,163
--	-----------

Amounts reported for *governmental activities* in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Add - capital outlay	567,750
Add - Infrastructure additions	2,867,940
Deduct - depreciation expense	(2,323,834)

Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the funds.

Equipment retirements	(51,430)
Increase in compensated absences	(14,904)

Installment lease contract proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of debt principal is an expenditure in the funds but not in the statement of activities:

Proceeds from installment lease	(153,500)
Lease purchase installment principal payments	19,865

Change in net assets of governmental activities	<u>\$ 1,009,050</u>
---	---------------------

The accompanying notes are an integral part of these financial statements.

HILLSDALE COUNTY ROAD COMMISSION
(A Component Unit of Hillsdale County)

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL**

GENERAL FUND

YEAR ENDED DECEMBER 31, 2004

(With Comparative Actual Amounts for the Year Ended December 31, 2003)

	2004				2003 Actual
	Original Budget	Amended Budget	Actual	Over (Under) Amended Budget	
Revenues					
Michigan Transportation Fund	\$ 4,424,000	\$ 4,680,000	\$ 4,728,730	\$ 48,730	\$ 4,432,749
State critical bridge fund	118,500	112,000	112,970	970	50,770
Economic development funds	499,000	490,000	502,756	12,756	746,541
Federal aid grants	752,000	722,000	724,046	2,046	547,903
Charges for services - state maintenance	531,800	796,000	817,384	21,384	471,063
Townships	823,400	780,000	788,712	8,712	847,667
Special assessments	-	-	-	-	10,848
Licenses and permits	22,000	18,000	18,235	235	27,950
Interest on investments	15,000	9,000	10,542	1,542	17,714
Land and building sale	-	-	-	-	85,000
Equipment disposals gain (loss)	162,400	170,000	181,158	11,158	(4,751)
Miscellaneous	34,000	69,000	68,461	(539)	86,079
Total revenues	7,382,100	7,846,000	7,952,994	106,994	7,319,533
Expenditures					
Primary road heavy maintenance	1,424,200	1,475,000	1,449,601	(25,399)	1,200,503
Primary road maintenance	1,561,000	1,661,000	1,648,652	(12,348)	1,608,099
Primary structures heavy maintenance	576,400	567,000	562,098	(4,902)	17,466
Primary structures maintenance	20,000	26,000	17,933	(8,067)	25,343
Local road heavy maintenance	642,300	859,000	837,865	(21,135)	824,561
Local road maintenance	2,246,300	2,385,000	2,372,136	(12,864)	2,329,300
Local structure heavy maintenance	62,600	19,000	18,376	(624)	393,268
Local structure maintenance	11,000	11,000	1,831	(9,169)	11,016
State trunkline maintenance	652,500	807,000	817,384	10,384	576,798
Equipment expenses - net	45,000	(23,000)	(131,173)	(108,173)	(46,628)
Administrative expenses - net	462,000	526,000	428,972	(97,028)	485,869
Capital outlay - net	(125,000)	(125,000)	(97,626)	27,374	(138,791)
Debt service	-	19,900	19,865	(35)	-
Other operating expenses	47,000	66,000	63,417	(2,583)	65,534
Total expenditures	7,625,300	8,273,900	8,009,331	(264,569)	7,352,338
Revenues over (under) expenditures	(243,200)	(427,900)	(56,337)	371,563	(32,805)
Other financing sources					
Capital lease proceeds	-	153,500	153,500	-	-
Net change in fund balance	(243,200)	(274,400)	97,163	371,563	(32,805)
Fund balance, beginning of year	1,244,405	1,244,405	1,244,405	-	1,277,210
Fund balance, end of year	\$ 1,001,205	\$ 970,005	\$ 1,341,568	\$ 371,563	\$ 1,244,405

The accompanying notes are an integral part of these financial statements.

HILLSDALE COUNTY ROAD COMMISSION

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Hillsdale County Road Commission (the “Road Commission”) conform to generally accepted accounting principles as applied to governmental units. The following is a summary of the significant policies.

Reporting Entity

The Hillsdale County Road Commission, referred to as the Road Commission, is a discrete component unit of the County of Hillsdale, Michigan. The Road Commission was established pursuant to the county road law (MCL 224.1), and is governed by a three member Board of County Road Commissioners elected by Hillsdale County voters.

The criteria established by the Governmental Accounting Standards Board Statement No. 14, “The Financial Reporting Entity”, for determining the reporting entity includes having financial accountability. Based on the above criteria, these financial statements present the Hillsdale County Road Commission, a discretely presented component unit of Hillsdale County, and include the Road Commission General Operating Fund.

The Road Commission General Operating Fund is used to control the expenditures of Michigan Transportation Fund monies distributed to the County, which are earmarked by law for street and highway purposes. The Board of County Road Commissioners has responsibility for the administration of the Road Commission’s General Operating Fund.

Basis of Presentation

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the activities of the primary government. *Governmental activities* are supported by charges for services and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Internally dedicated resources are reported as general revenues rather than as program revenues.

As permitted by GASB Statement No. 34, the Road Commission uses an alternative approach reserved for single program governments to present combined government-wide and fund financial statements by using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column. Accordingly, this is presented in the Statement of Net Assets and Governmental Funds Balance Sheet and the Statement of Activities and Governmental Fund Revenues, Expenditures and Changes in Fund Balances. The general fund, the sole major governmental fund, is reported as a separate column in the aforementioned financial statements.

HILLSDALE COUNTY ROAD COMMISSION

NOTES TO FINANCIAL STATEMENTS

Measurement Focus Basis of Accounting and Financial Statement Presentation

The government-wide financial statements (statement of net assets and the statement of activity) are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund (general fund) financial statements (general fund balance sheet and general fund revenues, expenditures and changes in fund balance) are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences not expected to be paid in the current year and claims and judgments, are recorded only when payment is due.

State and grant revenue, licenses and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The government reports the following major governmental fund:

The *general fund* is the government's primary operating fund. It accounts for all financial resources of the general government.

Budgetary Data

The governmental fund is under formal budgetary control. Budgets shown in the financial statements are adopted on a basis consistent with generally accepted accounting principles (GAAP), and are not significantly different from the modified accrual basis used to reflect actual results, and consist only of those amounts contained in the formal budget as originally adopted or amended by the Board of County Road Commissioners. The budget for the general operating fund is adopted on a functional level basis. Budget variances at the functional level, if any, are disclosed on the Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual.

HILLSDALE COUNTY ROAD COMMISSION

NOTES TO FINANCIAL STATEMENTS

Inventory

Inventory consists of various operating parts, supplies, and road material, and the cost is recognized using the consumption method (inventories recorded as expenditures when they are used). Inventories are stated at average cost determined on a first-in, first-out method, except for road materials, which are determined on the average cost method, and are not in excess of fair value.

Fund Balance Reservations and Designations

Portions of fund equity are segregated for future use, and are, therefore, not available for future appropriation. Amounts are reserved for inventories for monies already spent to show the amount of fund balance not currently available for expenditures. Designations of unreserved fund balances in governmental funds indicate the Road Commission's intention to use this portion of fund balance in the subsequent year.

Capital Assets

Capital assets, which include property, equipment and infrastructure assets (roads, bridges and similar items) are reported in the government-wide statements. Infrastructure assets are being capitalized and depreciated beginning in fiscal year 2004 as indicated on the government-wide statements. Capital assets are defined by the Road Commission as assets with an initial cost of \$200 or more and an estimated life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date donated.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Capital assets are recorded as capital expenditures at the time of purchase in the fund financial statements and are subsequently capitalized on the government-wide statements through an adjustment to the governmental fund (general fund) column.

The Uniform Accounting Procedures prescribed for Michigan County Road Commissions provide for recording depreciation in the General Operating Fund as a charge to various expense accounts and a credit to the depreciation contra expense account. Accordingly, the annual depreciation expense does not affect the available operating fund balance of the General Operating Fund.

Depreciation is recorded over the estimated useful lives (ranging from five to fifty years) of the assets, using the sum-of-years digits method for road equipment and straight-line method for all other capital assets and infrastructure as follows:

<u>Asset Category</u>	<u>Useful Life in Years</u>
Buildings and improvements	40
Equipment	4 to 8
Infrastructure	8 to 50

HILLSDALE COUNTY ROAD COMMISSION

NOTES TO FINANCIAL STATEMENTS

Deferred Compensation Plan

The Road Commission offers its employees a deferred compensation plan created in accordance with IRS section 457. The plan, available to all Commission employees, permits them to defer a portion of their current salary until future years. A trust has been established for the plan assets and the related assets and liability are not included in the Road Commission's financial statements.

Long-term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities. Bond premiums and discounts are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. As permitted by GASB Statement No. 34, the Road Commission has elected to apply the provisions related to bond premiums, discounts, and issuance costs on a prospective basis.

Compensated Absences

Under existing general Road Commission rules and regulations and its Labor Agreement, all regular full-time employees are eligible for paid leave in varying amounts based on number of years of service completed by each employee as of the preceding calendar year.

Sick leave is accumulated, for employees with one year or more of service, at the rate of one day for each month of service, not to exceed a total accumulation of 60 days. Accumulated sick pay at 100% is payable to employees upon death or retirement and 50% for employees who quit or are discharged.

Accumulated vacation pay is payable 100% to employees in case of retirement, resignation, discharge or death.

2. CASH AND CASH EQUIVALENTS

Deposits

At December 31, 2004, the amount of the Road Commission's deposits were as follows:

	Carrying Amount	Bank Balance
Petty cash	\$ 100	\$ -
Insured	-	100,000
Uninsured – uncollateralized Held by Hillsdale County *	-	151,618
Liquid savings accounts	179,453	-
	<u>\$ 179,553</u>	<u>\$ 251,618</u>

HILLSDALE COUNTY ROAD COMMISSION

NOTES TO FINANCIAL STATEMENTS

* Deposits of the Road Commission held by Hillsdale County may be partially covered by federal depository insurance. The amount of federal depository insurance is determined for the County as a whole, but cannot be separately identified for the Road Commission.

Statutes authorize the Road Commission to invest funds in the following:

- Bonds, securities, other obligations and repurchase agreements of the United States, or an agency or instrumentality of the United States
- Certificates of deposit, savings accounts, deposit accounts or depository receipts of a qualified financial institution
- Commercial paper rated at the time of purchase within the 2 highest classifications established by not less than 2 standard rating services and that matures not more than 270 days after the date of purchase
- Bankers acceptances of United States banks
- Obligations of the State of Michigan and its political subdivisions that, at the time of purchase are rated as investment grade by at least one standard rating service
- Mutual funds registered under the investment company act of 1940 with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation
- External investment pools as authorized by Public Act 20 as amended through 12/31/97

HILLSDALE COUNTY ROAD COMMISSION

NOTES TO FINANCIAL STATEMENTS

3. CAPITAL ASSETS

Changes in the components of the capital assets are summarized as follows:

	Balance January 1, 2004	Additions	Deductions	Adjustments and Reclassifications	Balance December 31, 2004
Capital assets not being depreciated:					
Land	\$ 74,434	\$ -	\$ -	\$ -	\$ 74,434
Land improvements - infrastructure	3,280,407	422,908	-	-	3,703,315
Subtotal	3,354,841	422,908	-	-	3,777,749
Capital assets being depreciated:					
Buildings and improvements	2,037,665	2,757	-	-	\$ 2,040,422
Road equipment	5,314,532	559,924	505,849	-	5,368,607
Shop equipment	88,722	3,140	4,448	(1,238)	86,176
Office equipment	132,686	511	597	-	132,600
Engineers' equipment	60,800	253	5,900	1,093	56,246
Yard and storage	426,599	1,165	799	-	426,965
Depleteable assets	70,400	-	-	-	70,400
Infrastructure	38,130,256	2,445,032	-	-	40,575,288
Subtotal	46,261,660	3,012,782	517,593	(145)	48,756,704
Accumulated depreciation and depletion					
Buildings and improvements	341,537	65,059	-	-	406,596
Equipment	4,397,248	549,574	466,850	542	4,480,514
Depleteable assets	67,156	-	-	-	67,156
Infrastructure	16,538,722	1,709,201	-	-	18,247,923
Total accumulated depreciation and depletion	21,344,663	2,323,834	466,850	542	23,202,189
Total capital assets being depreciated - net	24,916,997	688,948	50,743	(687)	25,554,515
Governmental activities capital assets - net	\$ 28,271,838	\$ 1,111,856	\$ 50,743	\$ (687)	\$ 29,332,264

HILLSDALE COUNTY ROAD COMMISSION

NOTES TO FINANCIAL STATEMENTS

4. LONG-TERM DEBT

Long-term debt of the Road Commission consists of the following:

	Balance January 1, 2004	Increases	(Decreases)	Balance December 31, 2004	Due Within One Year
Installment lease purchase	\$ -	\$ 153,500	\$ 19,865	\$ 133,635	\$ 75,218
Compensated absences	333,906	14,904	-	348,810	-
	\$ 333,906	\$ 168,404	\$ 19,865	\$ 482,445	\$ 75,218

The installment lease purchase agreement consists of an obligation for an excavator. Quarterly payments of \$19,865 include interest of 4.0% with the last payment due September 16, 2006. At December 31, 2004 the balance due is \$133,635. Amounts due are as follows:

	<u>Principal</u>	<u>Interest</u>
2005	\$ 75,217	\$ 4,241
2006	58,418	1,176

5. RETIREMENT PLAN

Plan Description

The Road Commission's defined benefit pension plan provides retirement and disability benefits and death benefits to plan members and beneficiaries. The Road Commission participates in the Municipal Employees Retirement System of Michigan (MERS), an agent multiple-employer plan administered by the MERS Retirement Board. Act No. 427 of the Public Acts of 1984, as amended, establishes and amends the benefit provisions of the participants in MERS. The Municipal Employees Retirement System of Michigan issues a publicly available financial report that includes financial statements and required supplementary information for MERS. That report may be obtained by writing to the Municipal Employees Retirement System of Michigan, 1134 Municipal Way, Lansing, Michigan 48917, or by calling (800) 767-6377.

Funding Policy

The Road Commission is required to contribute at an actuarially determined rate; the current employer's contribution rate of annual covered payroll is 3.74% for Association members and 11.90% for non-Association members. The contribution requirements of the Road Commission are established by Act No. 427 of the Public Acts of 1984, as amended, and may be amended by the Retirement Board of MERS. The contribution requirements of plan members, if any, are established and may be amended by the Road Commission. In addition, Road Commission Association employees are required to contribute 3.3% of annual compensation, and non-Association 5.3%.

HILLSDALE COUNTY ROAD COMMISSION

NOTES TO FINANCIAL STATEMENTS

Annual Pension Cost

For the year ended December 31, 2004, the Road Commission's annual pension cost of \$123,395 for MERS was equal to the Road Commission's required and actual contributions. The required contribution was determined using the entry age actuarial cost method. The actuarial assumptions included (a) a rate of return on the investment of present and future assets of 8.0%, (b) projected salary increase of 4.5% per year compounded annually, attributable to inflation, and (c) additional projected salary increases of 0.0% to 4.50% per year, depending on age, attributable to seniority/merit. The actuarial value of MERS assets was determined on the basis of a valuation method that assumes the fund earns the expected rate of return, and includes an adjustment to reflect market value. The Road Commission's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 2003, the date of the latest actuarial report, was 30 years.

Three-Year Trend Information

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
12/31/02	\$ 91,519	100%	\$ -
12/31/03	111,598	100	-
12/31/04	123,395	100	-

Schedule of Funding Progress

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL) - Entry Age</u>	<u>Unfunded Actuarial Liability (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
12/31/01	\$ 2,854,840	\$ 3,940,766	\$ 1,085,926	72%	\$ 1,812,002	60%
12/31/02	3,022,118	4,197,737	1,175,619	72	1,774,515	66
12/31/03	3,364,902	4,649,366	1,284,464	72	1,871,340	69

HILLSDALE COUNTY ROAD COMMISSION

NOTES TO FINANCIAL STATEMENTS

6. RISK MANAGEMENT

The Road Commission is a member of the Michigan County Road Commission Self-Insurance Pool “Pool” established pursuant to the laws of the State of Michigan which authorizes contracts between municipal corporations (inter local agreements) to form group self-insurance pools, and to prescribe conditions to the performance of these contracts.

The Michigan County Road Commission Self-Insurance Pool was established for the purpose of making a self-insurance pooling program available for Michigan County Road Commissions, which includes, but is not limited to, general liability coverages, auto liability coverages, property insurance coverages, stop loss insurance protection, claims administration, and risk management and loss control services pursuant to Michigan Public Act 138 of 1982.

The Hillsdale County Road Commission pays an annual premium to the Pool for general liability, excess liability, errors and omissions, auto liability, auto comprehensive, auto collision, equipment and building and contents.

The agreement for the formation of the Pool provides that the Pool will be self-sustaining through member premiums and will purchase both specific and aggregate stop-loss insurance to the limits determined necessary by the Pool Board.

The Road Commission continues to carry commercial insurance for all other risks of loss, including life, health, and workers’ compensation insurances. Settled claims have not exceeded insurance coverage for the last three years.

7. CONTINGENCIES

Under the terms of various Federal and State grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such grants could lead to reimbursement to the grantor agencies. However, Road Commission management does not believe such disallowances, if any, will be material to the financial position of the Road Commission.

The Road Commission has been named as a defendant in various litigation involving lawsuits pending and notices of intent to file suit.

Management and legal counsel of the Road Commission expect no material losses in excess of insurances should an unfavorable outcome prevail. No provision for any loss has been made in the accompanying financial statements.

HILLSDALE COUNTY ROAD COMMISSION

NOTES TO FINANCIAL STATEMENTS

8. SINGLE AUDIT

Governmental and certain other entities which expend \$500,000 or more of direct federal dollars are subject to a single audit in accordance with the OMB Circular A-133. The Road Commission expended \$724,046 of federal/state dollars, which were passed through and administered by the Michigan Department of Transportation. The passed through monies will be included in the State of Michigan's single audit.

* * * * *

OPERATING FUND SCHEDULES

HILLSDALE COUNTY ROAD COMMISSION
(A Component Unit of Hillsdale County)

SCHEDULE OF CHANGES IN FUND BALANCES

YEAR ENDED DECEMBER 31, 2004

	Primary Road Fund	Local Road Fund	County Road Commission	Totals
Total revenue and other financing sources	\$ 4,244,326	\$ 2,621,773	\$ 1,240,395	\$ 8,106,494
Total expenditures	3,866,765	3,356,985	785,581	8,009,331
Revenue over (under) expenditures	377,561	(735,212)	454,814	97,163
Optional transfers and adjustments	(735,212)	735,212	-	-
Revenue over (under) transfers and adjustments	(357,651)	-	454,814	97,163
Fund balance, beginning of year	1,027,140	-	217,265	1,244,405
Fund balance, end of year	\$ 669,489	\$ -	\$ 672,079	\$ 1,341,568

HILLSDALE COUNTY ROAD COMMISSION**(A Component Unit of Hillsdale County)****SCHEDULE OF REVENUES****YEAR ENDED DECEMBER 31, 2004**

	Primary Road Fund	Local Road Fund	County Road Commission	Totals
State Aid:				
Michigan Transportation Fund				
Engineering	\$ 6,100	\$ 3,900	\$ -	\$ 10,000
Allocation	2,820,200	1,817,056	-	4,637,256
Urban roads	54,935	24,238	-	79,173
Snow removal	1,404	897	-	2,301
Critical bridge	112,926	44	-	112,970
Other MDOT	-	184	-	184
Economic Development Fund	490,242	12,514	-	502,756
	<u>3,485,807</u>	<u>1,858,833</u>	<u>-</u>	<u>5,344,640</u>
Federal Aid:				
Critical bridge	602,273	231	-	602,504
STP	121,542	-	-	121,542
	<u>723,815</u>	<u>231</u>	<u>-</u>	<u>724,046</u>
Charges for Services				
State trunkline maintenance	-	-	706,216	706,216
State trunkline nonmaintenance	-	-	111,168	111,168
	<u>-</u>	<u>-</u>	<u>817,384</u>	<u>817,384</u>
Contributions:				
Township, City, Private	26,003	762,709	-	788,712
Other Revenue:				
Salvage sales	-	-	6,258	6,258
Interest earned	8,701	-	1,841	10,542
Permit and inspection fees	-	-	18,235	18,235
Gain on equipment disposal	-	-	181,158	181,158
Other miscellaneous	-	-	62,019	62,019
	<u>8,701</u>	<u>-</u>	<u>269,511</u>	<u>278,212</u>
Total Revenue	<u>4,244,326</u>	<u>2,621,773</u>	<u>1,086,895</u>	<u>7,952,994</u>
Other Financing Sources				
Capital lease proceeds	-	-	153,500	153,500
Total Revenue and Other Financing Sources	<u>\$ 4,244,326</u>	<u>\$ 2,621,773</u>	<u>\$ 1,240,395</u>	<u>\$ 8,106,494</u>

HILLSDALE COUNTY ROAD COMMISSION
(A Component Unit of Hillsdale County)

SCHEDULE OF EXPENDITURES

YEAR ENDED DECEMBER 31, 2004

	<u>Primary Road Fund</u>	<u>Local Road Fund</u>	<u>County Road Commission</u>	<u>Totals</u>
Primary Road				
Heavy Maintenance	\$ 1,449,601	\$ -	\$ -	\$ 1,449,601
Maintenance	1,648,652	-	-	1,648,652
Local Road				
Heavy Maintenance	-	837,865	-	837,865
Maintenance	-	2,372,136	-	2,372,136
Primary Road Structure				
Heavy Maintenance	562,098	-	-	562,098
Maintenance	17,933	-	-	17,933
Local Road Structure				
Heavy Maintenance	-	18,376	-	18,376
Maintenance	-	1,831	-	1,831
State Trunkline Maintenance and Non-maintenance	-	-	817,384	817,384
Equipment Expense - Net	(39,916)	(73,798)	(17,459)	(131,173)
Administrative Expense - Net	228,397	200,575	-	428,972
Capital Outlay - Net	-	-	(97,626)	(97,626)
Debt Service - Principal	-	-	19,865	19,865
Other Expenditures	-	-	63,417	63,417
Total Expenditures	<u><u>\$ 3,866,765</u></u>	<u><u>\$ 3,356,985</u></u>	<u><u>\$ 785,581</u></u>	<u><u>\$ 8,009,331</u></u>

INTERNAL CONTROL AND COMPLIANCE



REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP



**INDEPENDENT AUDITORS' REPORT ON INTERNAL
CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER
MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

May 5, 2005

Members of the Board of County
Road Commissioners
County of Hillsdale, Michigan
Hillsdale, Michigan

We have audited the financial statements of the of the governmental activities and the major fund of the Hillsdale County Road Commission, a component unit of Hillsdale County, as of and for the year ended December 31, 2004, and have issued our report thereon dated May 5, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hillsdale County Road Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hillsdale County Road Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

However, we noted other matters involving the internal control over financial reporting that we have reported to management of Hillsdale County Road Commission in a separate letter dated May 5, 2005.

This report is intended solely for the information and use of management, the Board of County Road Commissioners, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Lehmann Johnson". The signature is written in a cursive, flowing style.



REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP



May 5, 2005

The Board of County Road Commissioners
of Hillsdale County, Michigan
Hillsdale, Michigan

We have audited the financial statements of **HILLSDALE COUNTY ROAD COMMISSION, a component unit of Hillsdale County**, as of and for the year ended December 31, 2004, and have issued our report thereon dated May 5, 2005. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Generally Accepted Auditing Standards

As stated in our engagement letter dated January 18, 2005, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Hillsdale County Road Commission. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Hillsdale County Road Commission's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we advised management about the appropriateness of accounting policies and their application. The significant accounting policies used by Hillsdale County Road Commission are described in Note 1 to the basic financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the Hillsdale County Road Commission during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the financial statements was:

- Management's estimate of the useful lives of depreciable capital assets is based on the length of time it is believed that those assets will provide some economic benefit in the future. We evaluated the key factors and assumptions used to develop the useful lives of those assets in determining that they are reasonable in relation to the financial statements taken as a whole.

Significant Audit Adjustments

For purposes of this letter, professional standards define a significant audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. These adjustments may include those proposed by us but not recorded by Hillsdale County Road Commission that could potentially cause future financial statements to be materially misstated, even though we have concluded that such adjustments are not material to the current financial statements. We proposed no audit adjustments that could, in our judgment, either individually or in the aggregate, have a significant effect on Hillsdale County Road Commission.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as Hillsdale County Road Commission's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

This letter and the accompanying memorandum is intended solely for the information and use of management, the Board of Commissioners, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in black ink, reading "Lehmann Lobson". The signature is written in a cursive, flowing style with a large initial 'L'.

HILLSDALE COUNTY ROAD COMMISSION

COMMENTS

For the Year Ended December 31, 2004

This memorandum does not affect our report dated May 5, 2005, on the financial statements of Hillsdale County Road Commission.

Cash internal controls

Presently, there is a policy that only one signer is required on all accounts payable checks. In order to enhance the internal controls in this area, we recommend that the Board consider having two signers for all accounts payable checks in excess of a level to be established by the Board. We note that other entities of similar size have a dual signature requirement for checks greater than \$10,000, or another amount in which the Board feels comfortable with.

* * * * *